



Financial Services Tax News

Financial Services Tax Group

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New Japan-France Tax Treaty

The Protocol to amend the Convention between Japan and France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion and Fiscal Fraud with respect to Taxes on Income (the "New Treaty") was signed on January 11, 2007. Upon completion of ratification by the two countries, the New Treaty will amend the current Japan-France treaty, which became effective in 1996.

This Newsletter focuses on amendments to the articles regarding dividends, interest, royalties, gains on share transfers, *tokumei kumiai* profit distributions, and social security payments in the New Treaty. These amendments are summarized as follows.

	Current Treaty		New Treaty	
Dividends	A company holding at least 15% of the outstanding shares or the voting rights of the company paying the dividend for the 6 month period prior to the end of the accounting period	0%*	A Japanese resident company holding directly or indirectly at least 15% of the outstanding shares of the French resident company paying the dividend for the 6 month period prior to the date on which entitlement to the dividends is determined	0%
		5%	A French resident company holding directly at least 15%, or directly or indirectly at least 25% of the voting rights of the Japanese resident company paying the dividend for the 6 month period prior to the date on which entitlement to the dividends is determined	
			A company holding, directly or indirectly, at least 10% of the outstanding shares or the voting rights of the company paying the dividend for the 6 month period prior to the date on which entitlement to the dividends is determined	5%
	Other than above	15%	Other than above	10%
Interest	Government, local authorities, Central banks, debts claims guaranteed by certain Government bodies,	0%	Interest income received by the following beneficial owners: (a) Government, local authorities, Central banks, debts claims guaranteed by certain Government bodies, (b) Banks, (c) Insurance companies, (d) Securities dealers, (e) Other non-financial institutions satisfying specified asset/liability tests (f) Pension funds or pension schemes	0%
	Other than above	10%	Other than above	10%
Royalties	Any beneficial owner	10%	Any beneficial owner	0%
Gains on share transfer	A share transfer deemed as a quasi-business transfer	Taxation in the source country	A share transfer deemed as a quasi-business transfer	Taxation in the source country
	Real estate holding company's share transfer		Real estate holding company's share transfer	
Tokumei-Kumiai (TK)	Exemption from taxation in the source country	0%	No exemption from taxation in the source country	20%

*If the limitation on benefits clause is met, the dividends would be exempt from withholding tax.

1. Withholding tax on dividends, interests and royalties

(1) Dividends

Under the New Treaty, the holding requirement to enjoy the withholding tax exemption or the 5% rate has been relaxed. The withholding rate for other dividends is also reduced. In addition, pension funds are eligible for treaty benefits.

Dividends can be exempted from withholding tax when paid to a beneficiary who satisfies certain requirements. These requirements are satisfied when (1) dividends are paid from a French resident company to a Japanese resident company that owns 15% or more of the outstanding shares, directly or indirectly, in the company paying the dividend for the six month period prior to the date on which entitlement to the dividends is determined; or (2) dividends are paid from a Japanese resident company to a French resident company that owns 15% or more of the voting rights directly, or 25% or more of the voting rights directly or indirectly, in the company paying the dividend for the six month period prior to the date on which entitlement to the dividends is determined. A withholding tax rate of 5% is imposed on dividends paid to a company that owns 10% or more of the voting rights, directly or indirectly, for the six month period prior to the date on which entitlement to the dividends is determined. A withholding tax rate of 10% will apply in all other circumstances.

However, dividends paid by a *tokutei mokuteki kaisha* (a special purpose company often used in real estate investments in Japan) or a J-REIT (Japan Real Estate Investment Trust), which, subject to certain conditions, can deduct dividends paid from their income, are not entitled to either the 5% reduced rate or the full exemption. Dividends from these entities will instead be subject to a 10% withholding tax rate.

(2) Interest

Interest income received by certain entities (such as governmental entities, the central bank, pension funds and certain financial institutions) is exempt from withholding tax in the source country. For other circumstances, a 10% withholding tax will be imposed.

(3) Royalties

Royalties are now exempted from withholding tax in the source country on income beneficially owned by a resident of the other contracting state.

2. Capital gains from sale of shares

The taxation of the capital gains from sale of shares has not changed substantially.

(1) Capital gains arising in the other Contracting State from the disposal of real estate holding company

Capital gains realized by a resident of a Contracting State from disposal of shares in a company situated in the other Contracting State, whose share value is derived at least 50%, directly or indirectly, from real estate situated in the other Contracting State may be taxed in the other Contracting State.

(2) Capital gains arising in the other Contracting States from the transfer of shares

With regard to profit realized by a resident of one Contracting State for the transfer of shares of a

company incorporated in the other Contracting State, the source country, being the country where the company resides, will have the right to impose tax on the profit when the following requirements are met:

- (a) If the shares held by the seller and other related persons amount to at least 25% of the total issued shares of such company throughout the taxable year of the sale; and
- (b) If the total shares sold or transferred by the seller and related persons during the taxable year of sale amount to at least 5% of the total shares issued in the company.

3. Tokumei Kumiai (“TK”) profit distributions

Under the current treaty, common market practice has been to consider TK profit distributions to a French TK investor under a Japanese TK arrangement as exempt from the 20% withholding tax rate imposed under Japanese domestic law. However, the New Treaty clarifies that TK profit distributions are subject to Japan’s 20% domestic withholding tax rate to non-resident investors.

4. Limitation on benefits

The current treaty includes a limitation of benefits provision on the exemption on dividends in order to avoid instances of treaty shopping. Under The New Treaty, a comprehensive limitation of benefits provision is included in order to limit treaty benefits to qualifying residents of Japan and France. The limitation of benefit test applies to investment income that may be fully exempted under the New Treaty, including certain dividends, interest, royalties and capital gains.

The benefit in the New Treaty is available only to qualified persons, which by definition includes individuals, qualified governmental entities, or the following:

- (a) A company if the principal class of its shares is listed or registered or admitted to dealings on a recognized stock exchange and is regularly traded on one or more recognized stock exchanges;
- (b) A company (such as a subsidiary of a listed company) 50% or more of whose interests or voting rights are held by a qualified person; and
- (c) A company - (i) in which shares representing at least 75% of the outstanding shares or voting rights of the company are owned, either directly or indirectly, by 7 or fewer persons who are equivalent beneficiaries under certain conditions; and (ii) other specified conditions of receipt of benefits under the relevant articles are satisfied.

In addition, an active business test and a competent authority test are provided in the New Treaty.

The New Treaty also contains anti-conduit rules and main purpose tests that are designed to limit treaty benefits together with general transfer pricing restrictions and in certain specified articles.

5. Social Security Provisions

If a resident individual of a Contracting State performs services in that Contracting State, social security payments made in the other Contracting State are deductible from the taxable income in that Contracting State where the individual is resident.

6. Effective dates

The New Treaty will become effective on the first day two months after the month of the later of the exchange of diplomatic notes indicating approval by the Diet in Japan and Parliament in France. If the New Treaty is implemented on or before December 31, 2007, it shall be applicable in the following manner:

(1) In Japan:

- (a) With regard to withholding taxes, it will be applicable to amounts taxable on or after January 1, 2008.
- (b) With regard to other income taxes, the New Treaty is applicable to any taxable year commencing on or after January 1, 2008.
- (c) With regard to other taxes, the New Treaty is applicable to any taxable year commencing on or after January 1, 2008.

(2) In France:

- (a) With regard to withholding taxes, the New Treaty will be applicable to taxable amounts on or after January 1, 2008.
- (b) With regard to other income taxes, the New Treaty is applicable to any taxable year commencing on or after January 1, 2008.
- (c) With regard to other taxes, the New Treaty is applicable to any taxable year commencing on or after January 1, 2008.

Qualifying conditions under the New Treaty are significantly more detailed than under the existing treaty and this extends to treaty application forms for Japanese tax remission. The above is a general summary only and investors are advised to seek detailed advice when applying or interpreting the provisions of the New Treaty to their particular circumstances.

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